

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY
ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION LTD]

CC:PA:LPD:PR (NOT-121556-10)
Room 5203, Internal Revenue Service
PO Box 7604, Ben Franklin Station
Washington, DC 20044

By email to: Notice.Comments@irs.counsel.treas.gov

1 November 2010

Dear Sir/Madam,

Foreign Account Tax Compliance ('FATCA') and *Notice 2010-60*

The Alternative Investment Management Association Ltd (AIMA) is pleased to have the opportunity to comment on *Notice 2010-60*, issued in August 2010, which relates to Chapter 4 of the Internal Revenue Code of 1986 entitled 'Taxes to Enforce Reporting on Certain Foreign Accounts', which was enacted as part of the Hiring Incentives to Restore Employment Act of 2010 (H.R. 2847) on 18 March this year.

We are responding to the request of the Treasury Department (Treasury) and the Internal Revenue Service (the IRS) for comments from the public regarding *Notice 2010-60* ("the Notice") which provides preliminary guidance regarding priority issues regarding Chapter 4 of the Internal Revenue Code of 1986 (which we shall refer to simply as FATCA).

About AIMA and its members

AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector ~ including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,100 corporate bodies in over 40 countries, with 11% based in the US and over 30% of AIMA members' total assets under management (AUM) managed by US investment advisers.

AIMA's submissions on specific provisions of FATCA

Further to our original submission to Treasury and the IRS dated 29 June 2010, we are pleased to respond specifically on the items on which Treasury and the IRS have sought additional information on pages 58/59 of *Notice 2010-60* ("the Notice"), and with comments on the approach to reporting as set out in Section IV of the Notice. We have also set out comments on additional points that we feel are important, but for which comments have not necessarily been requested in the Notice.

We understand that other fund industry bodies may also respond in respect of specific types of funds, for example traditional long-only funds, private equity etc. Our comments therefore concentrate on hedge funds ~ our members' industry ~ but many of the issues faced by hedge funds are common to all investment funds. Where this is the case, we have highlighted this in our responses below.

Notice Section V (E): FFIs Subject to Restrictions Prohibiting U.S. Account Holders

Treasury and the IRS thus request further comments on the following:

(1) specific information about the applicable laws and regulations that may result in an investment vehicle's determination to prohibit sales of its interests to U.S. persons

An investment vehicle may have two drivers which may lead it to conclude that it should seek to exclude U.S. investors from coming into the fund.

The first, and most important, consideration is the existing regulatory restrictions on selling funds within the USA, as set out in the United States Securities Act of 1933 ('1933 Act') and the United States Investment Company Act of 1940 ('1940 Act'). Many funds are unable or unwilling to comply with selling restrictions and therefore state clearly in their prospectus or offering memorandum that the fund is not for sale in the U.S.A to U.S. Persons as defined under Reg.S of the 1933 Act. The Reg.S definition does not correspond with that of U.S. Persons within FATCA and, in particular, does not pick up U.S. owned foreign persons.

A secondary issue is that U.S. investors investing in non-U.S. funds will typically need additional information from the fund to meet their tax reporting requirements and/or to avoid penal taxation. They may therefore expect the non-U.S. fund to provide additional reporting information above that which is normally available ~ for example, income and expenses analyses (i.e. K-1 equivalent details) for tax transparent funds or PFIC reporting for non-transparent funds. Such additional reporting can be both time-consuming and costly to produce and in many cases the number of U.S. investors would not be sufficient to justify the time and cost. Again, this leads many non-U.S. funds to conclude that prohibiting U.S. investors is in the best interest of the fund and its other (non-U.S.) investors. For both these reasons, it is contractually possible to exclude U.S. persons (from a securities law and U.S. tax law perspective) from being a direct investor in a non-U.S. fund. Furthermore, most funds reserve the right to compulsorily redeem non-compliant investors out of the fund and indeed, where funds have prohibitions on U.S. investors, funds do take steps to remove them from the fund if discovered.

(2) the categories of investment vehicles that may be covered by such laws and regulations

The sales restrictions are applicable to all collective investment vehicles that would need to be registered under either the 1933 Act or the 1940 Act. Tax disincentives to sales of non-U.S. funds into the U.S. apply to all funds, both tax transparent and non-transparent. However, U.S. tax-exempt investors do not necessarily get disincentivized by a failure of a non-U.S. fund to provide U.S. tax information to the extent that U.S. taxables would.

(3) examples of the distribution or similar agreements that prohibit sales of interests to U.S. persons

In Appendix A's Examples 1, 2 and 3, we reproduce samples of wording from hedge fund prospectuses and offering memoranda which demonstrate the types of prohibitions or exclusions which these funds have. There are no 'standard' exclusions as it is for each fund to determine whether and to what extent it wishes to accept or prohibit U.S. investors. Over time, however, market practice tends to determine general templates for prospectuses and offering memoranda. In our view, the examples given in Appendix A cover 90%-95% of the non-U.S. hedge fund population.

(4) information regarding the legally binding nature of such prohibitions and the penalties applicable to a violation of such prohibitions

A fund's prospectus or offering memorandum represents the fund's contractual 'promise' to its investors on what it will do and how it will operate. In choosing to subscribe for shares in the fund, the investor is primarily doing so on the basis of the representations set out in the prospectus. Most prospectuses include mechanisms whereby the fund's board of directors (or equivalent) is able to operate discretion over aspects of fund operation, which may include whether to accept subscriptions from investors who would otherwise be prohibited. In most cases, therefore, funds do not operate a 'hard' prohibition on U.S. investors because they are not required to do so under their prospectus. In practice, however, even where there is a 'soft' prohibition within the prospectus, many funds operate on the basis that it is a hard prohibition for the regulatory and reporting reasons set out above.

(5) the extent to which the AML/KYC laws used to enforce such a prohibition would apply in identifying U.S. persons (as defined for U.S. tax purposes) that may invest in such vehicles, directly or through ownership in one or more other entities

AML/KYC laws in the host country of a fund frequently require the fund promoter to establish the identity of a potential investor for the purposes of preventing money laundering. Such laws and their operation in practice differ country by country, although there may be a degree of comparability for those countries which have signed up to the FATF guidelines. It is the case, however, that most local AML/KYC laws will not require the same level of enquiry into the identity of indirect holders as would be required by FATCA as currently drafted. The operation of such laws is therefore able to offer a good, but partial, solution to the identification requirements of FATCA. Such rules will apply irrespective of the type of fund and, especially where funds are sold via third party intermediaries, identification of ultimate beneficial owners is likely to be impossible. Given the background and purpose of the law, Treasury needs to assess carefully the likelihood of detecting tax evasion by a U.S. person in circumstances/systems where it is virtually impossible to track down ultimate beneficiaries and where such circumstances were not structured for the avoidance of U.S. taxation.

(6) the extent to which purchases of interests by non-participating FFIs would be treated as unsuitable investments and the extent to which and mechanisms by which non-participating FFIs could be prohibited from purchasing such interests

It would be for each non-participating FFI to determine whether it still wished to invest in U.S. stocks and shares. Where such interests are a small part of an FFI's portfolio, it may take the view that the business case for continuing to invest outweighs the additional U.S. tax cost it will now suffer, as a result of FATCA. Alternatively, if the FFI's view is that the business case for holding U.S. investments is no longer strong, then it would be likely to divest from U.S. investments and switch to other, relatively more attractive, options. By contrast, where U.S. investment is a large part of an FFI's portfolio, being a non-participating FFI would place it at a competitive disadvantage to participating FFIs. In these circumstances, there will be behavioural pressure for funds to become participating FFIs. It should be noted that where a non-U.S. investment fund has a global investment platform, FATCA compliance could serve as a very large disincentive to investing in the U.S. Accordingly, a streamlined, reasonable approach to compliance required by the Treasury would be more suitable.

(7) approaches that would allow Treasury and the IRS to verify or otherwise ensure compliance with such prohibitions

In most instances, it will be difficult or impossible for Treasury and the IRS to ensure compliance with prohibitions set out in a fund's prospectus or by the wider prohibitions set out within FATCA. This is because, often, a fund does not have a direct relationship with its ultimate beneficial owners. This is less of an issue for hedge funds than traditional funds as hedge funds tend to have larger investments from institutional investors while traditional funds tend to have small, retail investors which are therefore much more numerous. Nevertheless, a hedge fund will not have the right to look through institutional investors or feeder funds to their ultimate beneficial owners. Where a fund engages third party distributors, it will be reliant on the contract with that distributor to enforce any restrictions on fund offering set out in the prospectus. Such contracts do not generally contain provisions for compliance audits. Instead, issues are resolved as and when they come to light.

Notice Section IV (8) and (C): Reporting on U.S. Accounts

Treasury and the IRS thus request comments on the approaches outlined in this section regarding the reporting of U.S. account information:

Currency translation

We note the statement that guidance will provide that amounts must be reported in US Dollars. We do not consider that this is a practical requirement nor will it necessarily provide the IRS with information any more useful than local currency reporting.

It is common practice for hedge funds to issue multiple share classes to investors denominated in, and available for subscription in, different currencies. This will also be the case for other types of funds, such as long-only traditional funds.

Within the international asset management industry, investor accounts will be subject to different reporting and record keeping systems, depending on the distribution channels and the operating platforms used by the various service providers in the fund management and distribution model.

These systems may not necessarily be equipped to convert account balances to US Dollars. Further, an investor may hold accounts/investments in different jurisdictions and currencies and consolidation of all of these into a single currency will create unnecessary administrative complexities and costs, including new system builds. Finally, even if a hedge fund manager's systems allowed for foreign currency reporting, in-house tables of exchange rates will vary from manager to manager and may not meet with the IRS requirements under the FATCA provisions.

In view of the points noted above, reporting of investor information and account balances in local (i.e. transaction) currency should be considered as providing sufficient information for the IRS under the terms of FFI agreements.

Value to report

It is our belief that within the hedge fund industry, and indeed the wider asset management industry, it would only be practical and appropriate to report an estimated highest value on an account during the year. The value of an account may vary on a daily basis (e.g. due to fluctuations in the value of a fund, exchange rate movements, management charges etc), even where there have been no purchases or redemptions by the investor/account holder. The reported value should therefore only be regarded as an estimate of the highest value and the FFI should not be subject to penalties in respect of estimated amounts. Furthermore, we do not consider that gross receipts and withdrawals would add value to the process.

Additional points

Bearer shares

Investment fund regulations and legislation in various jurisdictions permit investment funds to issue "bearer shares" in which the beneficial owner is the person who holds the share(s) in certificated, "physical" form.

For example, open ended funds domiciled in Germany and Luxembourg have historically been able to issue bearer shares and it is still permissible under the UCITS Directive to launch and distribute regulated investment funds which issue bearer shares. Although not covered by UCITS, Swiss domiciled funds have similarly been able to issue bearer shares.

Providing information to the IRS about U.S. accounts presents a significant challenge for FFIs which issue bearer shares. This is because the FATCA rules, as presently drafted, provide a clear incentive for FFIs to identify their U.S. account holders on an annual basis, yet there is no possibility of establishing the beneficial owners of bearer shares at a given point in time. Although the account opening and registration procedures will vary between jurisdictions, it is consistently the case that, after issue, there is no register which will record the share owners/beneficial owner at any point in time. Therefore, it will be impossible for FFIs that issue bearer shares with a term greater than one year to verify ownership on an annual basis and the anonymity of bearer shares therefore appears to be inconsistent with the scope of the FATCA rules.

Possible solutions for an affected FFI that desires to maintain a FATCA compliant business could be: divesting all U.S. investments that could generate payments subject to FATCA withholding and thus accounts subject to reporting; or only issuing financial instruments in registered form in order to clearly identify U.S. holders for purposes of complying with the FATCA reporting requirements. However, neither of these solutions is commercially attractive.

In view of these issues and the fact that bearer shares are currently in circulation, we ask that Treasury provide grandfathering in respect of bearer shares issued by investment funds prior to 31 December 2011.

Contractual funds and “affiliation”

The categories of investment funds that may fall within the definition of financial institutions include funds which are not established as corporate vehicles but are established under various local domestic provisions which allow for contractual funds, unit trusts or other entities which do not have legal status/corporate identity.

Such vehicles are common in the product ranges of many asset managers and may be established as regulated (e.g., UCITS) or unregulated vehicles. In our view, any guidance in respect of investment funds should provide that such vehicles will be recognised for the purpose of the FATCA provisions as separate legal entities comparable to, for example, similar vehicles established in corporate form. This will ensure/clarify that such contractual/trust vehicles are not considered to be within an affiliated group with the asset management company or group of companies which has launched and is responsible for the regulation and management of the vehicle.

Widely Held Investment Vehicles

The above comments have been made on the basis that FATCA, as currently drafted, does not provide widely held investment vehicles with an exemption from or limited application of FATCA. We note that the Joint Committee on Taxation provided the following comment in its Technical Explanation of the Revenue Provisions in the HIRE Act:

“For instance, it is anticipated that the Secretary may provide rules that would permit *certain classes of widely held collective investment vehicles*, and to the limited extent necessary to implement these rules, the entities providing administration, distribution and payment services on behalf of those vehicles, *to be deemed to meet the requirements of this provision.*”

It appears that the Notice has not addressed this point and we therefore wish to reiterate the comments we made in our initial submission to Treasury and the IRS on FATCA, dated 29 June 2010, in relation to widely held investment vehicles.

We believe that the IRS and Treasury should create a sub-category of FFI, governing widely held collective investment vehicles that are similar in many ways to exchange-traded funds.

This approach is based on the fact that:

- (i) information as to the identity of investors in collective investment funds is often held by transfer agents or other intermediaries and the investor base itself is subject to frequent change as investors move in and out of investments in the collective investment fund;
- (ii) an investor typically would need to hold his interest in the investment vehicle and/or transfer funds to acquire his interest or receive distributions through a securities firm, bank or other FFI, which would itself be obligated to report U.S. accounts; and
- (iii) in many situations, there are already prohibitions on actively marketing such vehicles to U.S. persons to avoid U.S. security law obligations (which prohibitions also apply to intermediaries holding interests in the funds).

Moreover, as discussed below, many of these funds already have well-developed procedures in place in order to comply with existing know-your-customer and anti-money-laundering rules. Where the interests are sold via distributors/intermediaries, funds rely on the anti-money laundering procedures of those intermediaries, undertaking an extensive due diligence process at the outset to ensure that such procedures comply with the standards of the relevant jurisdiction. All of these factors should provide adequate safeguards against unidentified U.S. holders.

Collective investment funds in this category, including hedge funds, should be deemed to meet the reporting requirements of *Section 1471* by disclosing any U.S. accounts with whom the vehicle has direct privity and whom the vehicle knows is a specified U.S. person (including through a known nominee or other agent of such person). Specifically, in this scenario, the FFI agreement relating to these collective investment funds would require the FFI to disclose those U.S. owners, on an annual basis, to the IRS (or, alternatively, to its U.S. withholding agent which, in turn, would disclose the U.S. owners to the IRS).

We believe that there are strong reasons for this procedure. Given the administrative burdens that the IRS faces in managing the execution, implementation, and subsequent enforcement of a large num-

ber of FFI agreements, creating a sub-category of FFI with a simplified agreement would benefit the IRS, as collective investment funds are estimated to be the largest category of FFI.

Non-U.S. funds treated as partnerships

We also wish to reiterate the comments we made in our 29 June 2010 submission in respect of non-U.S. partnerships. Consideration should be given to the relative benefits of implementing FATCA with respect to non-U.S. investment funds that are treated as partnerships for U.S. tax purposes. U.S. source dividends, interest and securities gains derived by a U.S. person through a foreign investment partnership are currently subject to duplicative reporting. The foreign partnership must report the U.S. person's distributive share of such items on a Schedule K-1. In addition, the U.S. broker or other payer that effects the payment of such items must report such payments on a Form 1099. Such redundancy presents a low risk of tax evasion for U.S. investors in foreign investment partnerships.

Should you have any questions on our letter or wish to have any more detail on any point, please let me know.

Yours faithfully,

Mary Richardson
Director of Regulatory & Tax
Department

cc:

Mr Steven Musher, Internal Revenue Service
(Steven.A.Musher@irs.counsel.treas.gov)

Ms Manal Corwin, Department of the Treasury
(manal.corwin@do.treas.gov)